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1 Timothy M. Hogan (004567)
2 ARIZONA CENTER FOR LAW
3 IN THE PUBLIC INTEREST
4 202 E. McDowell Rd., Suite 153
5 Phoenix, Arizona 85004
6 (602) 258-8850

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Attorneys for Southwest Energy Efficiency
Project and Natural Resources Defense Council

BEFORE THE ARIZONA CORPORATION COMMISSION

8 JEFF HATCH-MILLER, CHARIMAN
9 MARC SPITZER
10 WILLIAM A. MUNDELL
11 MIKE GLEASON
12 KRISTIN K. MAYES

12 IN THE MATTER OF THE APPLICATION OF
13 SOUTHWEST GAS CORPORATION FOR THE
14 ESTABLISHMENT OF JUST AND
15 REASONABLE RATES AND CHARGES
16 DESIGNED TO REALIZE A REASONABLE
17 RATE OF RETURN ON THE FAIR VALUE OF
18 THE PROPERTIES OF SOUTHWEST GAS
19 CORPORATION DEVOTED TO ITS
20 OPERATIONS THROUGHOUT THE STATE
21 OF ARIZONA

Docket No. G-01551A-04-0876

**OPENING BRIEF OF SOUTHWEST
ENERGY EFFICIENCY PROJECT
AND NATURAL RESOURCES
DEFENSE COUNCIL (SWEEP/NRDC)**

I. INTRODUCTION

19 Southwest Energy Efficiency Project ("SWEEP") is a public interest organization
20 dedicated to advancing energy efficiency as a means of promoting both economic prosperity and
21 environmental protection in the six states of Arizona, Colorado, New Mexico, Nevada, Utah, and
22 Wyoming. SWEEP works on state energy legislation, analysis of energy efficiency opportunities
23 and potential, expansion of state and utility energy efficiency programs as well as the design of
24 these programs, building energy codes and appliance standards, and voluntary partnerships with
25

1 the private sector to advance energy efficiency. Direct Testimony of Jeff Schlegel at 1.
2 (“Schlegel Direct”).

3 The Natural Resources Defense Council (“NRDC”) is a nonprofit organization of
4 scientists, lawyers and environmental specialists with over 23,000 members and on-line activists
5 in Arizona dedicated to protecting public health and the environment. NRDC has a long standing
6 interest in minimizing the societal costs of the reliable energy services that a healthy economy
7 requires. NRDC focuses on addressing its members’ interests in receiving affordable energy
8 services and reducing the environmental impact of energy consumption through utility
9 procurement of cost-effective energy efficiency and other environmentally and economically
10 sustainable resources. *Id.*

12 SWEEP/NRDC intervened in this case to support demand side management (“DSM”) programs and funding that have been proposed by Southwest Gas. SWEEP/NRDC believe that
14 these programs should be implemented without regard to whether the Commission approves the
15 decoupling mechanism proposed by the company.

16 **II. THE PUBLIC INTEREST IN INCREASING NATURAL GAS ENERGY**
17 **EFFICIENCY**

18 Natural gas DSM energy efficiency programs are in the public interest. Increasing gas
19 energy efficiency will provide significant and cost-effective benefits for Southwest Gas
20 customers, the natural gas and electric utility systems, the economy, and the environment.
21 Increasing natural gas energy efficiency will save consumers and businesses money through
22 lower energy bills, resulting in lower total costs for customers. Natural gas energy efficiency
23 programs will help mitigate fuel price increases and reduce customer vulnerability and exposure
24 to natural gas price volatility. Increasing natural gas energy efficiency will also diversify energy
25 resources, reduce air pollution and carbon emissions, and create jobs and improve the economy.

1 Natural gas energy efficiency is a reliable energy resource that costs less than other resources for
2 meeting the energy needs of customers in the Southwest Gas service territory. Schlegel Direct at
3 2.

4 **III. SOUTHWEST GAS PROPOSAL FOR INCREASED DSM PROGRAMS**
5 **AND FUNDING**

6 SWEEP/NRDC support the two existing and seven additional natural gas DSM programs,
7 and the DSM funding increase from \$0.6 million to \$4.385 million, proposed by Southwest Gas
8 and summarized with the following table.

9

Customer Sector	Program	Funding
Residential	Low-Income Energy Conservation	\$ 500,000
Residential	Energy Star Home Certification	250,000
Residential	Multi-Family New Construction	1,200,000
Residential	Residential Energy Conservation	200,000
Residential	Energy Star Appliances	800,000
Commercial/Industrial	Food Service Equipment	500,000
Commercial/Industrial	Efficient Commercial Building Design	500,000
Commercial/Industrial	Technology Information Center	35,000
Industrial	Distributed Generation	400,000
	Total	\$ 4,385,000

14

15 The proposed DSM programs will provide significant and cost-effective benefits for Southwest
16 Gas customers. All Southwest Gas customer classes and segments will have an opportunity to
17 participate in and benefit directly from at least one DSM program in the portfolio that Southwest
18 Gas proposed. Schlegel Direct at 4.

19 SWEEP/NRDC propose that funding for the residential new construction program
20 (ENERGY STAR Home Certification) should be increased, to at least \$1 million annually, to
21 better address the cost-effective opportunities in new construction throughout the Southwest Gas
22 service territory. Additional DSM funding is necessary to capture energy efficiency opportunities
23 in the fast-growing new home market, including promoting and incentivizing new homes that
24 exceed the ENERGY STAR threshold. Also, additional DSM funding is needed to offer the
25 program throughout the Southwest Gas service territory; the new home program should not be

1 limited to the Tucson area as the EAP program has been in the past. Total DSM program funding
2 would be \$5.135 million with the increase in residential new construction funding. Schlegel
3 Direct at 5.

4 SWEEP/NRDC support up to \$50,000 in DSM funding for the bill assistance element of
5 the LIEC program since it is a relatively low level of DSM funding focused on emergency
6 situations of low income customers, and given the additional information provided in Southwest
7 Gas rebuttal testimony.¹ If the \$50,000 is not spent on bill assistance emergencies in a given
8 year, it should be allocated to weatherization. SWEEP/NRDC suggest that the funding remain in
9 the Preliminary DSM Plan budget at this time, and that any proposed revisions to the scope and
10 budget of the LIEC program, including the bill assistance element, be reviewed by the
11 collaborative DSM working group prior to Southwest Gas submitting a Final DSM Plan.
12 Surrebuttal Testimony of Jeff Schlegel at 3.

14 The estimated societal benefits of the Southwest Gas DSM portfolio will be about two
15 times the societal cost (a benefit/cost ratio of about 2.0), based on the recent natural gas DSM
16 potential studies in Utah and New Mexico, and experience with gas DSM programs in other
17 states. The specific costs, benefits, and cost-effectiveness of the Southwest Gas DSM portfolio
18 and the individual DSM programs should be documented in the DSM portfolio and program
19 plan. Schlegel Direct at 5.

21 SWEEP/NRDC also propose a positive performance incentive that Southwest Gas would
22 earn if it implements effective DSM programs that meet program goals. The performance
23 incentive mechanism should be based largely on a portion of the net economic benefits of the
24 DSM program portfolio, supplemented with a small number of program-specific performance

25 ¹ Rebuttal testimony of Vivian Scott, p. 3, beginning at line 18.

1 metrics for some programs (e.g., number of customers served in the low income program). The
2 total incentive level should be capped at 10% of the DSM program funding, resulting in a
3 maximum performance incentive of \$513,500 in 2006, based on 2006 DSM program funding of
4 \$5.135 million. Total DSM funding would be \$5.649 million including the maximum
5 performance incentive amount. Schlegel Direct at 6.

6 The proposed performance incentive mechanism should be described in the DSM
7 portfolio and program plan to be submitted by Southwest Gas. The portion (%) of the net
8 economic benefits that Southwest Gas is eligible to receive should be proposed as a component
9 of the incentive mechanism design in the plan. The performance incentive mechanism should
10 include a threshold for minimum performance level; if actual performance is less than the
11 threshold Southwest Gas would not receive any incentive. The performance incentive earned
12 should be based on actual DSM results. *Id.*

14 The proposed DSM programs and the \$5.649 million total DSM funding level represent a
15 reasonable and meaningful level of DSM effort for Southwest Gas in 2006, during a year when
16 Southwest Gas is ramping up its DSM activities. The DSM program funding of \$5.135 million in
17 2006 is equivalent to about 0.8% of revenues, based on 2004 test year revenues.² *Id.*

18 SWEEP/NRDC agree with Southwest Gas that the current adjuster mechanism should be
19 used to recover the costs of Commission-approved DSM programs. All customer classes should
20 pay the surcharge in the future since there will be DSM programs to benefit all customer classes.
21 The adjuster mechanism should be used for the programs proposed by Southwest Gas, at the
22 level of funding SWEEP/NRDC recommend (\$5.649 million in 2006). Southwest Gas should be
23

24
25 ² \$5.135 million of 2006 DSM program funding divided by \$647.277 million of 2004 test year revenues, per
Southwest Gas Schedule E-6.

1 able to increase the level of the adjuster mechanism and the associated surcharge in the future,
2 without a rate case proceeding, if the Commission approves increases in DSM funding for
3 previously-approved programs or if the Commission approves additional DSM programs.

4 Schlegel Direct at 7.

5 SWEEP/NRDC urge approval of the Preliminary DSM plan attached as Exhibit SS-2 to
6 Schlegel Surrebuttal. All DSM programs should then be pre-approved by the Commission
7 before Southwest Gas should be allowed to include the program costs in any determination of
8 total DSM costs incurred. Southwest Gas should file a DSM portfolio and program plan
9 describing the details of the programs and their cost-effectiveness, within 120 days of the
10 Commission's order in this proceeding. The DSM portfolio and program plan should describe
11 the proposed programs, and include estimated benefits, costs, cost-effectiveness, and
12 measurement and evaluation plans for Commission review. *Id.*

14 Southwest Gas should implement and maintain a collaborative DSM working group to
15 solicit and facilitate stakeholder input, assist Southwest Gas in developing DSM programs,
16 advise Southwest Gas on program implementation, and review DSM program performance
17 including program evaluations and reports. The DSM working group should review draft DSM
18 plans, proposals, and reports prior to Southwest Gas submitting them to the Commission. If
19 Southwest Gas does not submit a DSM program proposal considered by the collaborative DSM
20 working group to the Commission, any member of the working group may submit the program
21 proposal directly to the Commission for its consideration and approval. At a minimum, Staff,
22 RUCO, AECC, the Arizona State Energy Office, SWEEP, and NRDC should be invited to
23 participate with Southwest Gas in the collaborative DSM working group. *Id.*; Schlegel
24 Surrebuttal at 3.

1 **IV. FINANCIAL DISINCENTIVE TO NATURAL GAS UTILITY SUPPORT**
2 **OF ENERGY EFFICIENCY**

3 Traditional utility regulation links the utility's financial health to the volume of natural
4 gas sold, resulting in a financial disincentive to invest in energy efficiency and other demand-
5 side resources that reduce natural gas sales. The financial disincentive is particularly strong for
6 natural gas utilities that have experienced an overall trend of declining gas usage per customer,
7 which is the situation for Southwest Gas. Schlegel Direct at 8. For Southwest Gas, energy
8 savings by customers (which are beneficial for customers) result in lower revenues for the
9 company and threaten recovery of utility fixed costs. In general, this financial disincentive can
10 reduce utility support and enthusiasm for cost-effective resources such as energy efficiency
11 programs that minimize the long-term cost of providing service. It also could impede potentially
12 crucial utility support for energy-efficiency standards, building energy codes, and other policies
13 that serve societal interests and reduce energy use without requiring any direct utility investment.
14 Schlegel Direct at 7-8.

15
16 SWEEP/NRDC agree that the issue of the financial disincentive to natural gas utility
17 support of energy efficiency should be addressed in Arizona in a timely manner. This will be
18 necessary if Arizona wants to fully tap the potential for its lowest cost natural gas resource –
19 cost-effective energy efficiency improvements. *Id.*

20 SWEEP/NRDC believe that the gas utility financial disincentive issue and a full analysis
21 of the pros and cons of mechanisms for removing the financial disincentive, including but not
22 limited to the Conservation Margin Tracker ("CMT"), should be reviewed and evaluated prior to
23 Commission adoption of a specific mechanism. This issue would benefit from a broader and
24 more in-depth discussion, in this proceeding or in another forum. SWEEP/NRDC recommend
25 that a wider range of mechanisms that break the link between the utility's financial health and

1 energy sales, including decoupling, be further explored by the Commission before a particular
2 mechanism is adopted. SWEEP/NRDC also recommend that the Commission give consideration
3 to the following questions, among others, when developing or reviewing any proposed
4 mechanism to address the financial disincentive for natural gas utilities:

- 5 1. Who should bear responsibility for weather variations and associated weather risk?
- 6 2. Who should bear the risks of variations in economic growth from forecasted levels
7 and overall demographic and energy usage trends?

8 *Id.*

9
10 If not addressed fully in this proceeding, in the manner described above, SWEEP/NRDC
11 recommend that the issue of the financial disincentive and potential mechanisms to address it be
12 discussed in the DSM policy process, either through additional comments on the proposed DSM
13 policies or through additional DSM policy workshops. Proposed policies or mechanisms
14 resulting from the DSM policy process should then be submitted to the Commission. *Id.*

15 While SWEEP/NRDC are sympathetic to the financial issues Southwest Gas has raised,
16 including the declining average consumption per residential customer and the impact of
17 additional energy savings on Southwest Gas and while SWEEP/NRDC support the joint
18 statement of American Gas Association and NRDC, DSM programs and funding should be
19 approved by the Commission in any event, and not be linked to the outcome of the CMT and
20 customer rate design issues, because of the significant cost-effective benefits to customers
21 including the assistance to customers in mitigating future increases in natural gas prices.

22 Schlegel Surrebuttal at 3.
23
24
25

1 **V. CUSTOMER RATE DESIGN: FIXED CHARGES AND FLAT OR ONE-**
2 **TIER RATE**

3 SWEEP/NRDC oppose higher fixed charges for natural gas customers because higher
4 fixed charges would mute and reduce the price signal customers would receive when they reduce
5 energy use and become more energy efficient thereby reducing the ability of customers to
6 manage their own utility bills. Schlegel Surrebuttal at 5.

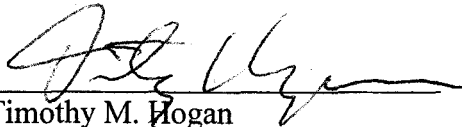
7 SWEEP/NRDC support the concept of a flat or one-tier rate structure proposed by
8 RUCO, and do not support the continuation of a two-tiered declining rate structure. A one-tier
9 rate structure would provide greater encouragement for customers to reduce their natural gas
10 consumption through increased energy efficiency and conservation. *Id.*

11 **VI. CONCLUSION**

12 SWEEP/NRDC urge the Commission to implement programs, policies, and mechanisms
13 that *encourage* cost-effective energy efficiency, not discourage it, for customers and for natural
14 gas utilities. Increasing natural gas energy efficiency will provide significant and cost-effective
15 benefits for Southwest Gas customers, the natural gas and electric utility systems, the economy,
16 and the environment.

17 **DATED** this 4th day of November, 2005.

18 ARIZONA CENTER FOR LAW IN
19 THE PUBLIC INTEREST

20
21 By 
22 Timothy M. Hogan
23 202 E. McDowell Rd., Suite 153
24 Phoenix, Arizona 85004
25 Attorneys for Southwest Energy
Efficiency Project and Natural Resources
Defense Council

1 ORIGINAL and 13 COPIES of
2 the foregoing filed this 4th day
of November, 2005, with:

3 Docketing Supervisor
4 Docket Control
5 Arizona Corporation Commission
1200 W. Washington
Phoenix, AZ 85007

6 COPIES of the foregoing
7 mailed this 4th day of
8 November, 2005 to:

9 Andrew Bettwy
Southwest Gas Corporation
5241 Spring Mountain Road
10 Las Vegas, NV 89102

11 Raymond S. Heyman
12 Laura E. Sixkiller
Roshka, Heyman & DeWulf
13 One Arizona Center
400 E. Van Buren Street, Suite 800
14 Phoenix, AZ 85004
Attorneys for Tucson Electric Power
15 *Company*

16 Michelle Livengood
17 Tucson Electric Power Company
One S. Church Street, Suite 200
18 Tucson, AZ 85702

19 Peter Q. Nyce, Jr.
General Attorney
20 Regulatory Law Office
Department of Army
21 901 N. Stuart Street
22 Arlington, VA 22203-1837

23 Scott S. Wakefield
RUCO
24 1110 W. Washington, Suite 220
Phoenix, AZ 85007

Walter W. Meek
AUIA
2100 N. Central Avenue, Suite 210
Phoenix, AZ 85004

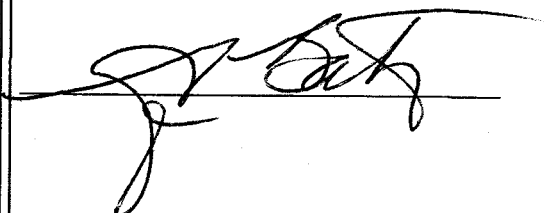
Cynthia Zwick
Arizona Community Action Association
2700 N. 3rd Street, Suite 3040
Phoenix, AZ 85004

Thomas H. Campbell
Lewis and Roca
40 N. Central Avenue
Phoenix, AZ 85004
Attorneys for Yuma Cogeneration
Associates

Thomas L. Mumaw
Karilee S. Ramaley
Pinnacle West Capital Corporation
MS 8695
Phoenix, AZ 85004

Christopher Kempley, Chief Counsel
Legal Division
Arizona Corporation Commission
1200 W. Washington Street
Phoenix, AZ 85007

1 Ernest G. Johnson, Director
2 Utilities Division
3 Arizona Corporation Commission
4 1200 W. Washington Street
5 Phoenix, AZ 85007
6
7
8
9
10
11
12
13
14
15
16
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18
19
20
21
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A handwritten signature in dark ink, appearing to read "E. Johnson", is written over a horizontal line. The signature is fluid and cursive, with the first letter "E" being particularly large and stylized.